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STABLE VALUE
RE-EXAMINED

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In a 2006 law journal article,[2] I argued based on quantitative analysis that stable value was superior to money market as the "income producing, low risk, liquid fund" required for participant-directed plans.[3] In this article, I review how that conclusion has held up through the period of market turbulence that has overall so adversely affected the value of participants' defined contribution (DC) account values.

According to a survey reported in the *Los Angeles Times*, participant 401(k) balances declined by 27.5 percent during 2008.[4] In 2008, the return on a stable value fund was 4.2 percent,[5] while that for the average retail money market mutual fund was 2.0 percent.[6] Participants with DC assets invested in stable value have every reason to be grateful to their employers for making it available. Obviously, returns during a single year of economic crisis are not a sound basis on which to draw conclusions about an asset class intended for use for retirement savings. However, I believe for many reasons that such a year provides a good reason first of all to revisit the comparison between stable value and money market, and secondly to discuss dispersion among stable value managers compared to that among other fixed-income managers.

OVERVIEW OF STABLE VALUE
Stable value must be considered a triumph of financial engineering. Stable value has been designed to offer DC plan participants the greatest yield consistent with protection of principal possible in the benefit plan environment. A DC pension plan is intended to accumulate funds for retirement over a long period. In an employee benefit plan, there will not usually be any other principal protected option in which a participant can invest. Plan provisions will restrict a participant's access to funds. Even when a plan permits a withdrawal, there may be tax disincentives to withdrawal that are significant. Taken together, these features mean that a stable value manager can plan on retaining the assets longer, and can invest the funds with an expectation that demands for cash will be less, and less volatile, than one would expect for a money market fund. A stable value wrap contract, required as a core element of all stable value offerings, assures that whatever liquidity is needed will be available.

These features mean that stable value returns will normally exceed those for money market funds. Unlike money market funds, which are governed by regulations meant to allow them to meet demands for cash that can arise for any reason, unconstrained by the restrictions of a pension plan or tax considerations, stable value shapes its investment policy to recognize the liquidity restraints imposed on DC plan participants by plan design and tax law. Simply put, money market may provide

2   PAUL J DONAHUE, *Plan Sponsor Fiduciary Duty for the Selection of Options in Participant-Directed Defined Contribution Plans and the Choice between Stable Value and Money Market,* 39:1 AKRON L. REV. 9 (2006) [hereinafter "SV and MM"].
3   *Ibid.,* at 18.
4   *http://latimesblogs.latimes.com/money_co/2009/01/401k-wall-stree.html*
5   All calculations based on returns for Stable Value are derived from monthly return data from the Hueler Analytics Stable Value Pooled Fund Index. I am very grateful for the willingness of Heuler Companies, especially to Kelly Hueler and Kathleen Schillo, to provide me with, and allow me to use for my work on this article, Hueler Index data. The returns are net 40 bps annually as an estimate of fees. In general, pooled funds are used more by smaller plans and have higher expenses than the Stable Value options of larger plans, so that that returns for all Stable Value plans are likely higher than the Pooled Fund Index returns. This means that the statistics displayed are conservative as illustrations for Stable Value in the aggregate .
6   All calculations based on returns for money market are derived from monthly return data from an Imoneynet return series for retail mutual funds.
7   I discuss this topic in more detail in SV and MM, at 23-27.

Quantitative Comparisons between Stable Value and Money Market				
	Annualized Returns SV	MM	Return SV/MM Ratio	Accumulations of $100/month SV/MM ratio
15 Years	5.2%	3.6%	142.7%	112.2%
10 Years	4.7%	2.9%	161.5%	110.3%
5 Years	4.1%	2.9%	141.8%	103.1%

more liquidity than a DC plan will normally need, resulting in a significant yield penalty relative to stable value products.[7]

QUANTITATIVE COMPARISONS BETWEEN STABLE VALUE AND MONEY MARKET[8]

The table above presents comparisons between stable value returns and the resulting accumulations and those for money market.

The differences with respect to retirement income between stable value and money market accumulations are significant. A payment of $250 per month made from a 15-year stable value accumulation that continues to pay interest at the 15-year stable value return would not be exhausted until the 152nd month. A payment of $250 per month made from a 15-year money market accumulation that continues to pay interest at the 15-year money market return would be exhausted in the 119th month.[9]

STABLE VALUE MANAGERS COMPARED TO FIXED INCOME MANAGERS GENERALLY

The table on page 28 presents comparisons of the percentile performance of stable value, intermediate and core fixed income managers. The returns are not strictly comparable, because the stable value returns are crediting rate returns, which, as noted in the table on page 28, reflect market value gains and losses over time in the credited rates, not market value total returns, while the returns for intermediate and core managers are current market value total returns.

The operation of the crediting rate formula smoothes stable value returns and will also smooth out year-to-year variations in manager performance. The one year numbers therefore say very little in fact about comparative dispersion, though they say a great deal about why participant satisfaction with stable value is currently so great!

8   See note 5 above.

9   Some might consider the case of the Lehman Brothers Stable Value Fund a counterexample. The speed of the demise of Lehman Brothers gave some of Lehman's Brothers Stable Value wrap providers a contractual basis to give notice that they would not provide wrap protection for certain categories of withdrawals. Under the accounting guidance for Stable Value, AAG INV-1, this required the write down to market of the assets covered by those contracts, which resulted in write-down for the whole fund of 1.7%. *See http://www.pionline.com/article/20090511/REG/905119993.* Even in this extreme case, the 2008 return for the Lehman Stable Value Fund was 2.0%, equal to the average retail money market fund return for 2008.

Manager Dispersion Comparisons								
	1 Year			5 Years			10 Years		
	Stable Value	Intermediate	Core	Stable Value	Intermediate	Core	Stable Value	Intermediate	Core
10th Percentile	5.00	4.00	4.50	5.01	4.49	4.73	5.63	5.83	6.20
25th Percentile	4.86	3.16	2.85	4.83	4.21	4.51	5.35	5.64	5.94
Median	4.60	2.49	-0.23	4.57	4.02	3.39	5.25	5.53	5.58
75th Percentile	4.32	-0.35	-2.22	4.38	3.31	2.78	5.07	5.25	4.89
90th Percentile	3.99	-1.50	-6.74	4.32	2.66	1.52	5.02	5.03	4.28
Members	40	28	40	39	28	40	32	28	39
Change from 25th to 75th	0.54	3.51	5.07	0.45	1.66	2.99	0.28	0.39	1.05
Change from 10 to 90th	1.01	5.5	11.24	0.69	3.21	5.42	0.61	0.8	1.92

However, much lower dispersion for stable value persists at five years, a period longer than the duration of almost all stable value funds, and even at 10 years. Stable value all-in management fees are generally lower than for other fixed-income managers, estimated by one manager of both stable value and total return fixed income assets at approximately 15 bps.[10] Looking at the 10 year numbers, stable value participants have received a return roughly equivalent to those for intermediate and core bond funds, with less dispersion among stable value managers than among intermediate managers and significantly less dispersion than among core managers.

Equivalent returns also means that stable value participants received point-to-point protection of principal with no sacrifice of return compared to intermediate and core fund investors.

CONCLUSION

Stable value has indeed proven its value over the period of recent turbulence and beyond. Its superiority as a plan's safe option has passed the test of last year's market turbulence. Indeed, given the effects of last year on other fixed income manager performance, stable value investors have received returns comparable to those of other fixed income funds, with less dispersion, and with point-to-point principal protection. 💰

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10 This includes total asset management fees for GICs, separate account GICs, the underlying assets of synthetic GICs and the synthetic wraps. The fee differential has its origin in the days when Stable Value management consisted largely of evaluating and purchasing GICs, but has persisted despite the migration of Stable Value asset management to include active management differing in objective but not in method from the active management deployed in other fixed income mandates.. Thus, some plan sponsors purchase active management within Stable Value at a much lower cost than they would be able to get it in an unwrapped bond fund. I am grateful to my former INVESCO colleague Stephen L. LeLaurin for the fee differential estimate. INVESCO is a leading Stable Value manager and also manages

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